

Message Text

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C O N F I D E N T I A L SECTION 1 OF 2 ANKARA 6177

EXDIS

DEPARTMENT PLEASE PASS TREASURY

E.O. 11652: XGDS-1
TAGS: EFIN, IMF, TU
SUBJECT: TURKEY'S IMF STANDBY PERFORMANCE

REFS: (A) STATE 214419, (B) ANKARA 6117 (NOTAL), (C) ANKARA
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SUMMARY: IN PRIVATE MEETING WITH EMBOFFS AUGUST 25,
CHARLES WOODWARD, HEAD OF IMF TEAM NOW IN ANKARA, SAID
THAT ALTHOUGH CASE COULD NOW BE MADE ON BASIS OF IMPROVED
TURKISH DATA THAT TURKEY WAS TECHNICALLY IN COMPLIANCE
WITH CONDITIONS FOR DISBURSEMENT OF SECOND TRANCHE OF ITS
STANDBY CREDIT OR ONLY IN DE MINIMIS VIOLATION, THE GOVERNMENT
HAD NOT OBSERVED THE SPIRIT OF ITS LETTER OF INTENT. WITHOUT
FURTHER IMPORTANT STABILIZATION MEASURES, IT WILL NOT BE
ABLE TO CONTROL ECONOMIC DETERIORATION AND MEET THIRD-TRANCHE
REQUIREMENTS. HE PLANNED TO SEEK FUND MANAGEMENT
APPROVAL OF HIS RECOMMENDATION THAT SECOND TRANCHE
DISBURSEMENT BE MADE IF HE COULD OBTAIN FIRM ASSURANCES
FROM PRIME MINISTER THAT GOT WOULD UNDERTAKE ADDITIONAL STABILIZATION
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MEASURES. UNDER COVER OF SECOND TRANCHE, STANDBY CONDITIONS
COULD THEN BE RENEGOTIATED. IF PRIME MINISTER DID NOT PROVIDE
ASSURANCES, WOODWARD FELT THAT HE MIGHT HAVE TO RECOMMEND DIS-
BURSEMENT ANYWAY IN VIEW OF DE MINIMIS NATURE OF TURKEY'S
VIOLATIONS. RECOMMENDATION
IN THIS CASE WOULD BE MADE WITH UNDERSTANDING THAT THERE
WOULD BE NO THIRD TRANCHE. EVEN IF SECOND TRANCHE IS

DISBURSED, HE THOUGH BANKS WOULD WITHHOLD NEW MONEY AND WAIT TO OBSERVE TURKISH ECONOMIC PERFORMANCE THROUGH TIME WHEN THIRD TRANCHE IS DUE IN LATE NOVEMBER. WOODWARD BELIEVED THAT COMMERCIAL BANKS HAD BECOME SKEPTICAL OF WILL AND ABILITY OF GOT TO ATTACK ITS ECONOMIC PROBLEMS. HE REGARDED TURKISH EFFORTS TO PRESSURE IMF THROUGH US AS LIMITING HIS FLEXIBILITY SINCE TURKS WOULD INTERPRET CONCESSIONS ON HIS PART AS RESULTS OF THEIR OWN LOBBYING IN WASHINGTON RATHER THAN AS ATTEMPT BY FUND TO GET THEM TO TAKE ADDITIONAL REFORM MEASURES. END SUMMARY.

1. CHARLES WOODWARD, IMF TURKISH DESK OFFICER, MET PRIVATELY WITH EMBOFFS EVENING OF AUGUST 25 AT HIS INITIATIVE. THINKING OUT LOUD OVER DINNER, WOODWARD SET FORTH THE SITUATION WITH REGARD TO THE TURKISH STANDBY AGREEMENT AS OF THAT TIME.

2. STATUS OF STANDBY: THE FUND'S CASE FOR WITHHOLDING TURKEY'S SECOND TRANCHE DRAWING HAS BEEN WEAKENED. THE GOVERNMENT HAD GIVEN THE IMF TEAM NEW FIGURES THAT MORNING WHICH INDICATED THAT TURKEY HAD STAYED WITHIN ITS STANDBY LIMITATIONS ON CENTRAL BANK CREDIT TO THE PUBLIC SECTOR AND NET DOMESTIC ASSETS. ACCEPTANCE OF THESE FIGURES WOULD REQUIRE THE FUND TO AGREE TO RECLASSIFY CERTAIN ITEMS IN THE CENTRAL BANKS'S BALANCE SHEET FROM DOMESTIC TO FOREIGN
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LIABILITIES. HOWEVER, WOODWARD SAID THAT, FOR THE FIRST TIME, THE TURKISH CALCULATIONS DID SEEM TO ADD UP. FURTHER, WHILE IT COULD BE ARGUED THAT THE TURKISH EXPORT REBATE SYSTEM WAS, IN EFFECT, THE IMPLEMENTATION OF A MULTIPLE EXCHANGE RATE PRACTICE (PROHIBITED BY THE STANDBY), THE TURKS APPEARED TO HAVE GROUNDS FOR CLAIMING THAT THE SYSTEM MERELY REIMBURSED EXPORTERS FOR TAXES ACTUALLY PAID. IN ADDITION, IMF LAWYERS WERE APPARENTLY RELUCTANT TO MAKE A DETERMINATION WHETHER OR NOT CERTAIN AGREEMENTS RECENTLY ENTERED INTO CONSTITUTE BILATERAL BARTER ARRANGEMENTS PROSCRIBED UNDER THE TERMS OF THE STANDBY.

3. GIVEN THE PROBLEMATIC STATUS OF TURKEY'S STANDBY PERFORMANCE, WOODWARD SAID THAT EVEN IF THE IMF STAFF MAINTAINED ITS PRESENT RECOMMENDATION AGAINST DISBURSEMENT OF THE SECOND TRANCHE, THE TURKS HAVE INDICATED THAT THEY WILL MAKE A FORMAL REQUEST TO DRAW IT, ARGUING THAT THE IMF STAFF HAD DEMINIMIS GROUNDS FOR DENYING DISBURSEMENT. SUCH A MOVE WOULD BE UNPRECEDENTED IN IMF HISTORY, ACCORDING TO WOODWARD. HE MUSED ALOUD WHAT KIND OF A PROBLEM THIS CASE MIGHT PRESENT TO THE US EXECUTIVE DIRECTOR; WOULD HE SIDE WITH TURKEY OR THE

STAFF?

4. IN ORDER TO AVOID SUCH A CONFRONTATION, WOODWARD PLANNED TO TELEPHONE THE FUND MANAGEMENT THAT NIGHT TO DISCUSS THE POSSIBILITY OF OFFERING A COMPROMISE TO THE TURKS. HE TENDED, AT THE TIME OF OUR CONVERSATION, TO RECOMMEND DISBURSEMENT OF THE SECOND TRANCHE IF HE COULD GET A COMMITMENT FROM THE TURKS TO TAKE SOME ADDITIONAL ECONOMIC STABILIZATION MEASURES. (WOODWARD DID NOT SPECIFY WHAT THESE MEASURES MIGHT BE.) UNDER COVER OF THE SECOND TRANCHE, THE TURKS AND THE IMF COULD RENEGOTIATE THE TERMS OF THE ORIGINAL STANDBY.

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5. IN ORDER TO GET THE MOST MEANINGFUL COMMITMENT POSSIBLE, WOODWARD SAID THAT HE WOULD INSIST ON MEETING WITH THE PRIME MINISTER. (WOODWARD BELIEVED THAT HIS REQUEST TO MEET WITH ECEVIT DURING HIS VISIT IN JULY HAD BEEN FRUSTRATED BY MINISTER OF STATE HIKMET CETIN, WHO, HE FELT WAS AMONG THOSE GIVING THE PRIME MINISTER BAD ADVICE.) WOODWARD HAD MISGIVINGS ABOUT THIS COURSE BECAUSE HE DOUBTED THE VALUE OF TURKISH ASSURANCES, EVEN IF THEY CAME FROM THE PRIME MINISTER; HE DID NOT THINK THE GOVERNMENT WAS STRONG ENOUGH TO DELIVER ON ITS PROMISES.

6. FAILING A COMMITMENT FROM THE TURKS, WOODWARD'S FALLBACK WAS TO RECOMMEND SECOND TRANCHE DISBURSEMENT

TO AVOID CHARGE OF WITHHOLDING IT ON DE MINIMIS GROUNDS,
BUT WITH THE UNDERSTANDING THAT THERE WOULD BE NO THIRD
TRNCHE. (WOODWARD IMPLICITLY ASSUMES THAT CURRENT
TURKISH POLICIES -- THE LACK OF WAGE RESTRAINTS,
UNWILLINGNESS TO DEVALUE, CONTINUATION OF PETROLEUM
SUBSIDIES -- WOULD MAKE IT HIGHLY UNLIKELY THAT
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TURKEY COULD MEET THIRD TRANCHE STANDBY TARGETS)

7. COMMERCIAL BANK CREDIT: WOODWARD FELT THAT,
FINANCIALLY, IT MADE LITTLE DIFFERENCE TO THE TURKS
WHETHER OR NOT THE SDR 40 MILLION SECOND TRANCHE WAS DISBURSED.
TURKISH PROBLEMS DWARFED THE SIZE OF POSSIBLE FUND
ASSISTANCE. COMMERCIAL BANKS WOULD NOT COME FORWARD WITH NEW MONEY
EVEN IF THE FUND PROCEEDED WITH THE SECOND TRANCHE DISBURSEMENT.
BANKS, HE THOUGHT, HAD BECOME SKEPTICAL ABOUT THE
ABILITY AND WILL OF THE GOT TO TAKE THE NECESSARY
MEASURES TO STABILIZE THE ECONOMY AND RESTORE
CREDITWORTHINESS. THE GOODWILL EARNED BY THE GOVERNMENT'S
SPRING STABILIZATION MEASURES HAD BEEN DISSIPATED BY THE
LACK OF FURTHER DISPLAY OF GOT DETERMINATION TO EFFECT
BASIC ECONOMIC REFORMS. THE BANKS PROBABLY WOULD NOT
MOVE TO PROVIDE NEW MONEY UNTIL NOVEMBER OR DECEMBER,
IN ORDER TO BE ABLE TO JUDGE TURKISH PERFORMANCE IN
MEETING NOT ONLY THE SECOND TRANCHE TARGETS, BUT THE
THIRD AS WELL.

8. WOODWARD WAS CONCERNED THAT THE FUND SHOULD NOT
DEBASE ITSELF IN ITS DEALINGS WITH TURKEY. THE FUND
WOULD NOT WANT TO GO AHEAD WITH DISBURSEMENT OF THE
SECOND TRANCHE WHEN THE PERCEPTION OF BANKS AND OTHERS
WAS THAT TURKEY WAS NOT PERFORMING ADEQUATELY AND HAD
NO PROGRAM FOR IMPROVED PERFORMANCE. IF HE COULD GET
NO ASSURANCES THAT THE TURKS WOULD TAKE ADDITIONAL
MEASURES, HE WONDERED WHETHER IT MIGHT NOT BE BEST, BOTH
FOR TURKEY AND FOR THE FUND, TO DENY THE SECOND TRANCHE.

9. HE COMMENTED THA TURKEY'S ATTEMPT TO PRESSURE THE
IMF THROUGH THE US HAD LIMITED HIS FLEXIBILITY TO DEAL WITH THE
SITUATION SINCE CONCESSIONS ON HIS PART COULD BE
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INTERPRETED BY THE TURKS AS RESULTING FROM THEIR LOBBYING
EFFORTS IN WASHINGTON RATHR THAN FROM AN ATTEMPT BY THE
FUND TO INDUCE THE TURKS TO TAKE THE ADDITIONAL MEASURES

NEEDED TO IMPROVE THEIR ECONOMY.

10. COMMENT: BOTH THE IMF AND THE TURKS HAVE CONTRIBUTED TO THE FUND'S PRESENT DILEMMA. THE FACT THAT THE STANDBY REQUIREMENTS WERE SO LOOSELY STRUCTURED AS TO ALLOW A SITUATION TO ARISE WHEREBY TURKEY COULD TECHNICALLY MEET THE LETTER OF ITS STANDBY REQUIREMENTS WITHOUT HAVING TAKEN ADEQUATE STABILIZATION MEASURES, IS CLEARLY THE FAULT OF THE FUND. BUT THE WEAK ECEVIT GOVERNMENT, FOR ITS PART, HAS LACKED THE POLITICAL COURAGE TO TAKE THE UNPLEASANT DECISIONS NEEDED TO STABILIZE THE ECONOMY AND HAS DISCIPLINED ITSELF ECONOMICALLY ONLY TO THE EXTENT NECESSARY TO MEET IMF TECHNICAL CONDITIONS.

11. ADDENDUM: OVER THE WEEKEND, LOCAL PRESS REPORTED THAT IMF HAD FOUND THE MEASURES TAKEN BY TURKEY TO BE SATISFACTORY, THEY WERE NOT SUFFICIENT TO OVERCOME TURKEY'S PROBLEMS AND ADDITIONAL MEASURES WOULD BE NEEDED. IT WAS REPORTED THAT WOODWARD, FINANCE MINISTER MUEZZINOGLU, AND TURKISH IMF EXECUTIVE DIRECTOR DEGROOTE, WOULD BE MEETING WITH PRIME MINISTER ECEVIT ON MONDAY, AUGUST 28 TO DISCUSS THESE ADDITIONAL MEASURES.
DILLON

NOTE BY OC/T: NOT PASSED TREASURY.

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